



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:

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Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
75-100-06

Department of Natural Resources

October 1, 2003 through September 30, 2005

Released:
June 2006

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Statements and Financial Schedules:

Auditor's Reports Issued

We issued unqualified opinions on the Department of Natural Resources' (DNR's) financial statements and financial schedules.

~ ~ ~ ~ ~

Internal Control Over Financial Reporting

We did not identify any material weaknesses in internal control over financial reporting. However, we did identify reportable conditions (Findings 1 through 5).

~ ~ ~ ~ ~

Noncompliance or Other Matters Material to the Financial Statements and/or Financial Schedules

We did not identify any instances of noncompliance or other matters applicable to the financial statements and/or financial schedules that are required to be reported under *Government Auditing Standards*.

~ ~ ~ ~ ~

Federal Awards:

Auditor's Reports Issued on Compliance

We audited 6 programs as major programs and issued 6 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

~ ~ ~ ~ ~

Internal Control Over Major Programs

We did not identify any material weaknesses in internal control over major programs. However, we did identify reportable conditions (Findings 6 through 10).

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 6 through 9).

~ ~ ~ ~ ~

Systems of Accounting and Internal Control:

We determined that DNR was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program or Cluster Title</u>	<u>Compliance Opinion</u>
10.664	Cooperative Forestry Assistance	Unqualified
10.665	Schools and Roads - Grants to States	Unqualified
15.605 and 15.611	Fish and Wildlife Cluster	Unqualified
15.634	State Wildlife Grants	Unqualified
15.916	Outdoor Recreation - Acquisition, Development and Planning	Unqualified
97.012	Boating Safety Financial Assistance	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 29, 2006

Mr. Keith J. Charters, Chair
Natural Resources Commission
and
Ms. Rebecca A. Humphries, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Natural Resources (DNR) for the period October 1, 2003 through September 30, 2005.

This report contains our report summary; our independent auditor's reports on the financial statements and on the financial schedules; and the DNR financial statements and financial schedules, notes to the financial statements and financial schedules, and supplemental financial statements and financial schedule. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains DNR's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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INDEPENDENT AUDITOR'S REPORTS,
FINANCIAL STATEMENTS, AND
FINANCIAL SCHEDULES



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

Mr. Keith J. Charters, Chair
Natural Resources Commission
and
Ms. Rebecca A. Humphries, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the accompanying financial statements of the Department of Natural Resources as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present the special revenue, permanent, and capital projects funds administered by the Department of Natural Resources and do not purport to, and do not, present fairly the financial position of the State of Michigan or its special revenue, permanent, and capital projects funds as of September 30, 2005 and September 30, 2004 and the changes in financial position

thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Department of Natural Resources' funds as of September 30, 2005 and September 30, 2004 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 19, 2006 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the supplemental financial statements, as identified in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.
Auditor General
April 19, 2006



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

Mr. Keith J. Charters, Chair
Natural Resources Commission
and
Ms. Rebecca A. Humphries, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the accompanying financial schedules of the Department of Natural Resources for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Natural Resources' General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a


complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Natural Resources for the fiscal years ended September 30, 2005 and September 30, 2004 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 19, 2006 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas H. McTavish", with a horizontal line extending to the left.

Thomas H. McTavish, C.P.A.
Auditor General
April 19, 2006

DEPARTMENT OF NATURAL RESOURCES
Combined Balance Sheet
As of September 30
(In Thousands)

	Governmental Fund Types							
	Special Revenue Funds		Permanent Funds		Capital Projects Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
ASSETS								
Cash	\$ 111	\$ 76	\$ 1	\$	\$	\$	\$ 112	\$ 76
Equity in common cash	105,664	149,782	140,733	253,926	1,996	3,128	248,393	406,836
Taxes, interest, and penalties receivable	205	233					205	233
Securities lending collateral	887	4,242	10,090	11,508			10,977	15,750
Amounts due from federal agencies	620	507					620	507
Inventories	143	146					143	146
Other current assets	5,875	4,378	13,549	8,580			19,424	12,958
Investments - Long-term (Note 2)	99,726	64,953	380,319	256,533			480,045	321,486
Noncurrent assets		30					0	30
Total Assets	\$ 213,230	\$ 224,348	\$ 544,692	\$ 530,547	\$ 1,996	\$ 3,128	\$ 759,918	\$ 758,023
LIABILITIES AND FUND BALANCES								
Liabilities:								
Warrants outstanding	\$ 625	\$ 619	\$ 249	\$ 191	\$	\$ 18	\$ 874	\$ 828
Accounts payable and other liabilities	11,747	25,741	3,360	41,641	53	241	15,160	67,623
Obligations under security lending	887	4,242	10,090	11,508			10,977	15,750
Amounts due to other funds	1,334	807	57	45			1,391	852
Deferred revenue - Current	440	391	3,384				3,824	391
Deferred revenue - Long-term		30					0	30
Total Liabilities	\$ 15,033	\$ 31,830	\$ 17,140	\$ 53,385	\$ 53	\$ 259	\$ 32,226	\$ 85,474
Fund Balances:								
Reserves for:								
Budgetary carry-forwards:								
Encumbrances	\$ 11,298	\$ 16,545	\$ 23,258	\$ 13,269	\$	\$	\$ 34,556	\$ 29,814
Restricted revenues (Note 3)	17,969	15,638					17,969	15,638
Multi-year projects	19,219	23,014	32,979	37,743			52,198	60,757
Funds held as permanent investments	107,032	99,930	425,993	383,132			533,025	483,062
Total Reserved	\$ 155,517	\$ 155,127	\$ 482,229	\$ 434,144	\$	\$	\$ 637,746	\$ 589,271
Unreserved	42,680	37,391	45,323	43,019	1,943	2,869	89,946	83,279
Total Fund Balances	\$ 198,197	\$ 192,518	\$ 527,552	\$ 477,163	\$ 1,943	\$ 2,869	\$ 727,692	\$ 672,550
Total Liabilities and Fund Balances	\$ 213,230	\$ 224,348	\$ 544,692	\$ 530,547	\$ 1,996	\$ 3,128	\$ 759,918	\$ 758,023

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES
Combined Statement of Revenues, Expenditures, and Changes in Fund Balances
Fiscal Years Ended September 30
(In Thousands)

	Governmental Fund Types							
	Special Revenue Funds		Permanent Funds		Capital Projects Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
REVENUES								
Taxes	\$ 329	\$ 282	\$	\$	\$	\$	\$ 329	\$ 282
From federal agencies	2,300	1,642					2,300	1,642
From licenses and permits:								
Boat registration	10,483	9,647					10,483	9,647
Camping fees	21,843	19,019					21,843	19,019
Hunting, fishing, and trapping licenses	49,421	48,304					49,421	48,304
Motor vehicle permits	13,168	12,495					13,168	12,495
Other licenses and permits	3,371	3,100					3,371	3,100
Miscellaneous:								
Interest and investment revenue	6,348	6,475	18,882	22,617	65	97	25,295	29,189
Unrealized gain(loss) on investments	3,791	(57)	5,359	(8,129)			9,150	(8,186)
Sale of timber	38,019	31,475					38,019	31,475
Oil, gas, and mineral royalties (Note 4)	6,231	4,795	66,607	50,963			72,838	55,758
Other miscellaneous revenue	3,113	3,698	158	15		3	3,271	3,716
Total Revenues	<u>\$ 158,417</u>	<u>\$ 140,874</u>	<u>\$ 91,006</u>	<u>\$ 65,466</u>	<u>\$ 65</u>	<u>\$ 100</u>	<u>\$ 249,488</u>	<u>\$ 206,441</u>
EXPENDITURES								
Current	\$ 150,265	\$ 146,130	\$ 16,009	\$ 14,188	\$	\$	\$ 166,274	\$ 160,318
General government	80	170	337	646			417	816
Capital outlay projects	12,805	18,974	24,391	17,403	991	10,268	38,187	46,645
Total Expenditures	<u>\$ 163,150</u>	<u>\$ 165,274</u>	<u>\$ 40,736</u>	<u>\$ 32,236</u>	<u>\$ 991</u>	<u>\$ 10,268</u>	<u>\$ 204,877</u>	<u>\$ 207,778</u>
Excess of Revenues Over (Under) Expenditures	<u>\$ (4,733)</u>	<u>\$ (24,400)</u>	<u>\$ 50,270</u>	<u>\$ 33,230</u>	<u>\$ (925)</u>	<u>\$ (10,168)</u>	<u>\$ 44,612</u>	<u>\$ (1,338)</u>
OTHER FINANCING SOURCES								
Proceeds from sale of capital assets	\$	\$	\$ 245	\$ 5,286	\$	\$	\$ 245	\$ 5,286
Transfers in:								
From Game and Fish Protection Trust Fund	10,615	10,696					10,615	10,696
Oil and gas royalties from Michigan Natural Resources Trust Fund			10,000	10,000			10,000	10,000
Gas tax from Michigan Transportation Fund	14,737	14,748					14,737	14,748
From Department of Environmental Quality's Natural Resources Damages Fund	485						485	0
Total Other Financing Sources	<u>\$ 25,837</u>	<u>\$ 25,444</u>	<u>\$ 10,245</u>	<u>\$ 15,286</u>	<u>\$</u>	<u>\$</u>	<u>\$ 36,082</u>	<u>\$ 40,730</u>
OTHER FINANCING USES								
Transfers out:								
To General Fund for other departments' services provided	\$ (4,810)	\$ (5,243)	\$ (125)	\$ (64)	\$ (1)	\$ (2)	\$ (4,936)	\$ (5,309)
To General Fund for budgetary savings		(559)				(319)	0	(878)
To other Department of Natural Resources' funds	(10,615)	(10,696)	(10,000)	(10,000)			(20,615)	(20,696)
Total Other Financing Uses	<u>\$ (15,424)</u>	<u>\$ (16,497)</u>	<u>\$ (10,125)</u>	<u>\$ (10,064)</u>	<u>\$ (1)</u>	<u>\$ (322)</u>	<u>\$ (25,550)</u>	<u>\$ (26,883)</u>
Total Other Financing Sources (Uses)	<u>\$ 10,413</u>	<u>\$ 8,947</u>	<u>\$ 120</u>	<u>\$ 5,221</u>	<u>\$ (1)</u>	<u>\$ (322)</u>	<u>\$ 10,532</u>	<u>\$ 13,846</u>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	<u>\$ 5,679</u>	<u>\$ (15,453)</u>	<u>\$ 50,390</u>	<u>\$ 38,451</u>	<u>\$ (926)</u>	<u>\$ (10,490)</u>	<u>\$ 55,143</u>	<u>\$ 12,508</u>
Fund Balances - Beginning of fiscal year	<u>192,518</u>	<u>207,972</u>	<u>477,163</u>	<u>438,711</u>	<u>2,869</u>	<u>13,358</u>	<u>672,550</u>	<u>660,041</u>
Fund Balances - End of fiscal year	<u>\$ 198,197</u>	<u>\$ 192,518</u>	<u>\$ 527,552</u>	<u>\$ 477,163</u>	<u>\$ 1,943</u>	<u>\$ 2,869</u>	<u>\$ 727,692</u>	<u>\$ 672,550</u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES
Schedule of General Fund Revenues and Other Financing Sources
Fiscal Years Ended September 30
(In Thousands)

REVENUES	2005	2004
From federal agencies	\$ 32,689	\$ 26,475
From services	1,298	
From licenses and permits:		
Snowmobile registration and trail fees	7,236	6,989
Off-road vehicle licenses	3,430	3,513
Other licenses and permits	1,162	1,159
Miscellaneous:		
Revenue from easements	653	580
Other miscellaneous	2,392	3,795
Total Revenues	<u>\$ 48,861</u>	<u>\$ 42,511</u>
OTHER FINANCING SOURCES		
Transfers from Michigan Transportation Fund	\$ 3,684	\$ 3,687
Proceeds from sale of capital assets	2,636	1,207
Total Other Financing Sources	<u>\$ 6,320</u>	<u>\$ 4,894</u>
Total Revenues and Other Financing Sources	<u><u>\$ 55,181</u></u>	<u><u>\$ 47,405</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF NATURAL RESOURCES
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal year Ended September 30
(In Thousands)

	<u>2005</u>	<u>2004</u>
SOURCES OF AUTHORIZATIONS (Note 5)		
General purpose appropriations	\$ 28,502	\$ 31,339
Budgetary adjustments	247	94
Balances carried forward	22,656	22,025
Restricted financing sources	55,089	48,728
Less: Intrafund expenditure reimbursements	<u>(573)</u>	<u>(1,798)</u>
 Total	 <u><u>\$ 105,921</u></u>	 <u><u>\$ 100,389</u></u>
 DISPOSITION OF AUTHORIZATIONS (Note 5)		
Gross expenditures and transfers out	\$ 80,610	\$ 77,191
Less: Intrafund expenditure reimbursements	<u>(573)</u>	<u>(1,798)</u>
Net expenditures and transfers out	<u>\$ 80,037</u>	<u>\$ 75,393</u>
Balances carried forward:		
Encumbrances	\$ 846	\$ 987
Restricted revenues - not authorized/used	<u>24,849</u>	<u>23,072</u>
Total balances carried forward	<u>\$ 25,695</u>	<u>\$ 24,060</u>
Balances lapsed	<u>\$ 189</u>	<u>\$ 937</u>
 Total	 <u><u>\$ 105,921</u></u>	 <u><u>\$ 100,389</u></u>

The accompanying notes are an integral part of the financial schedules.

Notes to the Financial Statements and Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and the changes in financial position of the following funds administered by the Department of Natural Resources (DNR) as of and for the fiscal years ended September 30, 2005 and September 30, 2004:

Special Revenue

Game and Fish Protection Fund

Michigan State Waterways Fund

Marine Safety Fund

Game and Fish Protection Trust Fund

State Park Improvement Fund

Combined Recreation Bond Fund - Local Projects

Michigan Nongame Fish and Wildlife Fund

Forest Development Fund

Permanent

Michigan Natural Resources Trust Fund

Michigan State Parks Endowment Fund

Michigan Civilian Conservation Corps Endowment Fund

Capital Projects

Combined Recreation Bond Fund - State Projects

These funds are a part of the State of Michigan reporting entity and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

The accompanying financial schedules report the results of the governmental operations of DNR for the fiscal years ended September 30, 2005 and September 30, 2004. The governmental operations of DNR are accounted for principally in the State's General Fund and are reported on in the *SOMCAFR*.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial statements and schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by generally accepted accounting principles applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial statements present only the funds listed in Note 1a. Accordingly, they do not purport to, and do not, present fairly the financial position and changes in financial position of the State of Michigan or its special revenue, permanent, and capital projects funds in conformity with generally accepted accounting principles.

The accompanying financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for DNR's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either DNR or the State's General Fund in conformity with generally accepted accounting principles.

The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; common cash; pension benefits and other post-employment benefits; deposits and investments; and interfund receivables and payables.

The financial transactions of DNR are recorded in the General Fund and in individual funds in the State's central accounting system. The various

natural resource funds are combined in the *SOMCAFR* into governmental fund types described as follows:

Special Revenue Funds: This fund group includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Permanent Funds: This fund group reports resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as State park preservation.

Capital Projects Fund: This group accounts for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes.

Note 2 Permanent Investments

By statute, the State Treasurer is responsible for investing balances available for permanent investment. The State Treasurer, by agreement with DNR, invests up to the amount available for permanent investment each year. DNR has provided asset allocation recommendations to the State Treasurer with respect to amounts to be held in the form of fixed income and equity portfolios. DNR has also implemented distribution plans for the various funds to determine the extent to which market value gains or losses are made available for program appropriation and spending.

Equities: Beginning in fiscal year 2002-03 for the Michigan Natural Resources Trust Fund and in fiscal year 2004-05 for all other funds with equity investments, DNR implemented investment distribution plans based upon a fixed distribution of earnings (for example, 5% of the equities portfolio). Excess earnings are retained in revenue stabilization reserves to be used in years when actual returns are less than that percentage. Prior to that time, only realized gains or losses were recognized for distribution purposes.

Fixed income: For fixed income portfolios, except for the Michigan Natural Resources Trust Fund, distributions of earnings are based upon interest income, plus or minus gains and losses realized upon redemption. This is based upon the assumption of DNR and past practice of the Michigan

Department of Treasury that these investments will generally be held to maturity (or called) for the purpose of generating interest. Because this portfolio is not actively traded, market value gains and losses are considered temporary and distribution is based upon interest income.

Note 3 Fund Balances Reserved for Restricted Revenue

The line entitled "Total Reserved" for special revenue funds on the combined balance sheet includes the following fund balances (in thousands) reserved for revenues restricted for specific purposes:

	September 30	
	2005	2004
<u>Game and Fish Protection Fund</u>		
Deer Habitat Improvement	\$ 6,172	\$ 6,010
Fisheries Settlement	1,561	1,251
Wildlife Resource Protection	466	638
Waterfowl Fees	1,691	1,701
Turkey Program	2,187	2,117
Youth Hunting and Fishing Education Outreach	288	261
Pittman-Robertson Program	816	581
Dingell-Johnson Program	115	107
Total	<u>\$ 13,296</u>	<u>\$ 12,666</u>
 <u>Michigan State Waterways Fund</u>		
Harbor Development Subfund	\$ 4,641	\$ 2,172
Total	<u>\$ 4,641</u>	<u>\$ 2,172</u>
 <u>State Park Improvement Fund</u>		
Haven Hill Area Consent Agreement	\$ 33	\$ 800
Total	<u>\$ 33</u>	<u>\$ 800</u>
 Total Restricted Revenue Reserves	<u><u>\$ 17,969</u></u>	<u><u>\$ 15,638</u></u>

Note 4 Gas Royalty Revenues

In 1997, the State sold certain natural gas production to a third party in order to capture certain tax credits (Section 29 of the Internal Revenue Code) being offered by the federal government. Under the provisions of the sale agreement, once a certain level of future production was reached, the State was to forward all revenues received to the buyer. DNR anticipated that this level of production would not be reached until after fiscal year 2004-05. However, in February 2006, it was reported by the outside contractor hired to determine production on the sold gas that the production level was reached as of July 1, 2005. As a result, the revenues of the Michigan Natural Resources Trust Fund and the Game and Fish Protection Trust Fund were overstated by \$6.1 million and \$0.7 million, respectively, in fiscal year 2004-05.

Therefore, in February 2006, the State paid the buyer the \$6.8 million attributable to the sold production generated during the period July 1, 2005 through September 30, 2005. The State will continue forwarding revenue generated from the sold natural gas production until a second production level is reached. This level is expected to be reached by December 2007.

Note 5 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.
- b. Budgetary adjustments: Adjustments for write-off of accounts receivable, deferrals, and prior year obligations in excess of prior appropriations.
- c. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized/used that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized/used. Act 111, P.A. 2003, transferred the off-road vehicle safety education fund from the Michigan Department of Education to DNR.

As a result, the balances carried forward amount reported as a budgetary source in fiscal year 2003-04 is \$180,052 higher than the balances carried forward amount reported as a budgetary disposition in fiscal year 2002-03. Executive Order No. 2004-2 transferred the delinquent property tax fund from DNR to the Michigan Department of Treasury. As a result, the balance carried forward amount reported as a budgetary source in fiscal year 2004-05 is \$1,404,666 lower than the balances carried forward amount reported as a budgetary disposition in fiscal year 2003-04.

- d. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized/used. Significant sources for DNR included federal fish and wildlife restoration funds (\$19.1 million and \$15.5 million in fiscal years 2004-05 and 2003-04, respectively), snowmobile trail improvement funds (\$8.9 million and \$8.6 million in fiscal years 2004-05 and 2003-04, respectively), and off-road vehicle trail improvement funds (\$3.4 million and \$3.5 million in fiscal years 2004-05 and 2003-04, respectively).
- e. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.
- f. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- g. Restricted revenues - not authorized/used: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. Significant carry-forwards of this type were for snowmobile

trail improvement fees (\$10.0 million and \$8.5 million in fiscal years 2004-05 and 2003-04, respectively) and off-road vehicle trail improvement fees (\$6.1 million and \$5.5 million in fiscal years 2004-05 and 2003-04, respectively).

- h. Balances lapsed: Authorizations that were unexpended or unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 6 Interfund Commitments

In fiscal year 2002-03, Act 746, P.A. 2002, required the transfer of \$7.8 million from the Michigan State Waterways Fund to the General Fund. The Act states that, in the future, the General Fund is to provide reimbursement. Interfund receivables and payables are not recorded for this commitment because there is no repayment schedule and the repayment is considered long-term and budgetary in nature.

Note 7 Payroll and Fringe Benefit Accrual

In fiscal year 2003-04, the Office of Financial Management, Department of Management and Budget, changed its method of computing and recording the accrued payroll and fringe benefit expenditures. In the *SOMCAFR*, the expenditures are not reported at the agency level; instead, they are presented at the Statewide level. The Office of Financial Management has issued a waiver that allows departments to report these transactions in their financial schedules for the fiscal year ended September 30, 2004. The schedule of sources and disposition of General Fund authorizations includes DNR's share of the accrued payroll expenditures in the amount of \$148,139, reflected as an increase to expenditures and transfers out and a decrease to balances lapsed. The schedule of expenditures of federal awards, however, does not include the accrued payroll amount because it was recorded at the Statewide summary level.

Note 8 Contingencies Related to Litigation

DNR accrues liabilities related to significant legal proceedings if a loss is probable and reasonably estimable. DNR is a party to various legal proceedings seeking damages or injunctive or other relief.

Comben v State of Michigan: The Court of Appeals held that, in light of Section 15 of the Severance Tax Act (Section 205.315 of the *Michigan Compiled Laws*), severed oil and gas are not subject to taxation and foreclosure under the General Property Tax Act. Plaintiff Antrim County Treasurer originally sought a declaratory ruling whether owners of severed oil and gas interests were entitled to notice of tax foreclosures under the new tax foreclosure process adopted by Act 123, P.A. 1999. The trial court and the Court of Appeals held that under the Severance Tax Act and the Dormant Minerals Act, severed oil and gas rights are not subject to taxation and foreclosure. An application for leave to appeal was granted by the Michigan Supreme Court, and the case was heard on March 8, 2006. A decision is anticipated by June 30, 2006.

The State presently holds mineral rights in only 2.1 million acres of land and mineral and surface rights in another 3.8 million acres of land, which reverted to the State for tax delinquencies and which are administered by DNR. The vast majority of these 5.9 million acres of mineral rights were obtained by tax foreclosures occurring before 1941. State revenues from oil and gas activities over the last 10 years have averaged approximately \$35 million annually. A separate class action to quiet title to severed oil and gas rights and for damages is presently in mediation. The action is consolidated with a Court of Claims action with the same name (Black Stone Minerals v State of Michigan).

SUPPLEMENTAL FINANCIAL STATEMENTS AND FINANCIAL SCHEDULE

Descriptions of Special Revenue Funds

GAME AND FISH PROTECTION FUND

This Fund was established in 1921 and currently operates under Part 435, Act 451, P.A. 1994, as amended, and is financed principally by the sale of hunting and fishing licenses. The license fees are set by statute and their purpose is to support the conservation program for preservation and control of fish and wildlife. The Fund also receives funding from the Game and Fish Protection Trust Fund. The Fund provides financial support for Statewide hunting and fishing programs, including resource management, research, enforcement of hunting and fishing laws, and acquisition of lands to be used for hunting and fishing purposes.

MICHIGAN STATE WATERWAYS FUND

This Fund was established in 1947 and operates under Part 781, Act 451, P.A. 1994, as amended. The Fund receives portions of watercraft registration fees and gasoline taxes, some of which are collected by other State agencies and transferred to this Fund. The Fund provides for improvement of lake harbors and inland waterways; construction, operation, and maintenance of recreational boating facilities; property acquisition; and administration.

In fiscal year 2002-03, Section 1602, Act 746, P.A. 2002, required the transfer of \$7.8 million from this Fund to the General Fund. Section 1602(3) states: "It is the intent of the legislature that in the future the general fund reimburse the state waterways fund." No receivable is recorded in this Fund for the commitment because there is no repayment schedule and the repayment is considered long-term and budgetary in nature.

MARINE SAFETY FUND

This Fund was established in 1967 and operates under Part 801, Act 451, P.A. 1994, as amended. The Fund is financed principally by 49% of watercraft registration fees imposed by this Act. The Fund provides for water safety education programs, law enforcement, and regulation of watercraft on the waters of this State.

GAME AND FISH PROTECTION TRUST FUND

This Fund was established in 1986 and operates under Part 437, Act 451, P.A. 1994, as amended, to restrict certain assets for the purpose of generating interest and earnings for transfer to the Game and Fish Protection Fund. In addition, the Legislature may appropriate up to \$6 million annually for use by the Game and Fish Protection Fund.

Additional investment funding is being provided by mineral royalties from lands acquired by the Game and Fish Protection Fund, timber sales, land sales, and other revenues that, by statute, are retained for permanent investment.

STATE PARK IMPROVEMENT FUND

This Fund was established in 1960 and operates under Part 741, Act 451, P.A. 1994, as amended. The Fund is primarily financed by State park use and concession fees and motor vehicle permit fees necessary for entry by motor vehicles into designated State parks. These fees are the primary funding source for the operation, maintenance, debt service, and improvements of the State park system. Approximately \$1.2 million of revenues of this Fund are pledged annually for repayment of State Park Gross Revenue Bonds.

COMBINED RECREATION BOND FUND - LOCAL PROJECTS

This Fund was established in 1988 and operates under Parts 196 and 715, Act 451, P.A. 1994, as amended. The balances remaining in the Fund reflect proceeds and investment earnings remaining from two bond packages. The first bond package was \$70 million of general obligation bonds approved by voters in November 1988 as part of a \$140 million bond package for financing State and local public recreation projects. The second bond package was \$50 million of general obligation bonds approved by voters in November 1998 as part of a \$675 million bond package known as the "Clean Michigan Initiative." The proceeds from the 1988 bond package were used to provide grants to local units of government in the amounts of \$65 million for local recreation projects and \$5 million to discourage development of open spaces and undeveloped lands. The proceeds from the 1998 bond package provided grants to local units of government for local recreation projects pursuant to Part 716, Act 451, P.A. 1994.

MICHIGAN NONGAME FISH AND WILDLIFE FUND

This Fund was established in 1983 and operates under Part 439, Act 451, P.A. 1994, as amended. Fund revenues are used to finance research and management of nongame fish and wildlife, designated endangered species, and designated plant species of this State. The Fund may receive transfers from other funds, donations, investment income, and revenue from specialty license plate sales.

FOREST DEVELOPMENT FUND

This Fund was established in 1993, along with the Michigan Forest Finance Authority, and operates under Part 505, Act 451, P.A. 1994, as amended. The Authority is authorized to acquire: standing timber, timber cutting rights, and the State's interest in

contracts granting cutting rights on State tax-reverted lands and on other lands in the State forest system. Revenues are derived from the sale of forest products and are pledged to provide debt service on any bonds or notes that might be issued by the Authority. The Authority may issue, but thus far has not issued, bonds. Revenues not used for debt service are major funding sources for the Forest, Mineral and Fire Management Division and are used for forest management operations and practices.

DEPARTMENT OF NATURAL RESOURCES
Combining Balance Sheet
Special Revenue Funds
As of September 30
(In Thousands)

	Game and Fish Protection Fund		Michigan State Waterways Fund		Marine Safety Fund		Game and Fish Protection Trust Fund	
	2005	2004	2005	2004	2005	2004	2005	2004
ASSETS								
Cash	\$ 3	\$ 4	\$ 7	\$	\$	\$	\$	\$
Equity in common cash	24,585	32,186	38,272	39,893	2,622	2,160	11,441	48,216
Taxes, interest, and penalties receivable			205	233				
Securities lending collateral	280	162					468	4,080
Amounts due from federal agencies	435	248			185	259		
Inventories			143	146				
Other current assets	3,762	3,454	27	9			1,803	784
Investments - Long-term	1,756	1,542					92,111	59,103
Noncurrent assets				30				
Total Assets	<u>\$ 30,822</u>	<u>\$ 37,597</u>	<u>\$ 38,653</u>	<u>\$ 40,312</u>	<u>\$ 2,807</u>	<u>\$ 2,419</u>	<u>\$ 105,823</u>	<u>\$ 112,183</u>
LIABILITIES AND FUND BALANCES								
Liabilities:								
Warrants outstanding	\$ 296	\$ 197	\$ 88	\$ 125	\$ 1	\$ 3	\$	\$
Accounts payable and other liabilities	3,552	7,384	1,607	2,022	1,785	1,895		9,993
Obligations under security lending	280	162					468	4,080
Amounts due to other funds	448	400	90	65	10			
Deferred revenue - Current								
Deferred revenue - Long-term				30				
Total Liabilities	<u>\$ 4,577</u>	<u>\$ 8,144</u>	<u>\$ 1,785</u>	<u>\$ 2,242</u>	<u>\$ 1,796</u>	<u>\$ 1,898</u>	<u>\$ 468</u>	<u>\$ 14,073</u>
Fund Balances:								
Reserves for:								
Budgetary carry-forwards:								
Encumbrances	\$ 2,651	\$ 2,803	\$ 5,898	\$ 11,169	\$ 35	\$	\$	\$
Restricted revenues	13,295	12,666	4,641	2,172				
Multi-year projects	758	2,285	16,109	19,061				
Funds held as permanent investments	1,718	1,781					99,355	92,111
Total Reserved	<u>\$ 18,422</u>	<u>\$ 19,535</u>	<u>\$ 26,648</u>	<u>\$ 32,402</u>	<u>\$ 35</u>	<u>\$ 0</u>	<u>\$ 99,355</u>	<u>\$ 92,111</u>
Unreserved	7,824	9,918	10,220	5,668	976	521	6,000	6,000
Total Fund Balances	<u>\$ 26,245</u>	<u>\$ 29,453</u>	<u>\$ 36,868</u>	<u>\$ 38,070</u>	<u>\$ 1,011</u>	<u>\$ 521</u>	<u>\$ 105,355</u>	<u>\$ 98,111</u>
Total Liabilities and Fund Balances	<u>\$ 30,822</u>	<u>\$ 37,597</u>	<u>\$ 38,653</u>	<u>\$ 40,312</u>	<u>\$ 2,807</u>	<u>\$ 2,419</u>	<u>\$ 105,823</u>	<u>\$ 112,183</u>

State Park Improvement Fund		Combined Recreation Bond Fund - Local Projects		Michigan Nongame Fish and Wildlife Fund		Forest Development Fund		Totals	
2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
\$ 100 7,857	\$ 71 7,939	\$ 2,436	\$ 4,154	\$ 448	\$ 2,185	\$ 1 18,003	\$ 1 13,048	\$ 111 105,664	\$ 76 149,782
				139				205	233
								887	4,242
								620	507
								143	146
60	29			59	34	164	68	5,875	4,378
				5,859	4,308			99,726	64,953
								0	30
<u>\$ 8,017</u>	<u>\$ 8,039</u>	<u>\$ 2,436</u>	<u>\$ 4,154</u>	<u>\$ 6,505</u>	<u>\$ 6,527</u>	<u>\$ 18,168</u>	<u>\$ 13,116</u>	<u>\$ 213,230</u>	<u>\$ 224,348</u>
\$ 57 1,537	\$ 121 1,497	\$ 406	\$ 69 1,150	\$ 3 59	\$ 29 46	\$ 180 2,800	\$ 76 1,754	\$ 625 11,747	\$ 619 25,741
				139				887	4,242
606	226	1	2	3	2	175	113	1,334	807
439	391							440	391
								0	30
<u>\$ 2,640</u>	<u>\$ 2,234</u>	<u>\$ 408</u>	<u>\$ 1,221</u>	<u>\$ 204</u>	<u>\$ 76</u>	<u>\$ 3,155</u>	<u>\$ 1,943</u>	<u>\$ 15,033</u>	<u>\$ 31,830</u>
\$ 429 33 1,282	\$ 663 800 639	\$	\$	\$ 19	\$ 46	\$ 2,264	\$ 1,863	\$ 11,298 17,969 19,219	\$ 16,545 15,638 23,014
				5,959	6,038			107,032	99,930
<u>\$ 1,745</u>	<u>\$ 2,102</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 5,978</u>	<u>\$ 6,084</u>	<u>\$ 3,335</u>	<u>\$ 2,893</u>	<u>\$ 155,517</u>	<u>\$ 155,127</u>
<u>3,632</u>	<u>3,704</u>	<u>2,028</u>	<u>2,934</u>	<u>323</u>	<u>366</u>	<u>11,678</u>	<u>8,280</u>	<u>42,680</u>	<u>37,391</u>
<u>\$ 5,377</u>	<u>\$ 5,805</u>	<u>\$ 2,028</u>	<u>\$ 2,934</u>	<u>\$ 6,301</u>	<u>\$ 6,451</u>	<u>\$ 15,013</u>	<u>\$ 11,173</u>	<u>\$ 198,197</u>	<u>\$ 192,518</u>
<u>\$ 8,017</u>	<u>\$ 8,039</u>	<u>\$ 2,436</u>	<u>\$ 4,154</u>	<u>\$ 6,505</u>	<u>\$ 6,527</u>	<u>\$ 18,168</u>	<u>\$ 13,116</u>	<u>\$ 213,230</u>	<u>\$ 224,348</u>

DEPARTMENT OF NATURAL RESOURCES
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Special Revenue Funds
Fiscal Years Ended September 30
(In Thousands)

	Game and Fish Protection Fund		Michigan State Waterways Fund		Marine Safety Fund	
	2005	2004	2005	2004	2005	2004
REVENUES						
Taxes	\$	\$	\$ 329	\$ 282	\$	\$
From federal agencies	1,949	1,332	161		185	259
From license sales and permits:						
Boat registration			5,347	4,920	5,137	4,727
Camping fees						
Hunting, fishing, and trapping licenses	49,419	48,300				
Motor vehicle permits						
Other licenses and permits	6	1	1,930	1,713		
Miscellaneous:						
Interest and investment revenue	718	444	1,042	516	104	43
Unrealized gain(loss) on investments	(36)	(35)				
Sale of timber	781	240	43			
Oil, gas, and mineral royalties	63	89				
Other miscellaneous revenue	1,316	1,189	1,167	976	136	94
Total Revenues	<u>\$ 54,216</u>	<u>\$ 51,561</u>	<u>\$ 10,018</u>	<u>\$ 8,407</u>	<u>\$ 5,561</u>	<u>\$ 5,123</u>
EXPENDITURES						
Current	\$ 64,384	\$ 60,609	\$ 17,948	\$ 23,254	\$ 3,902	\$ 4,333
General government	7	2				
Capital outlay projects	3,231	5,214	7,718	9,207		
Total Expenditures	<u>\$ 67,622</u>	<u>\$ 65,824</u>	<u>\$ 25,666</u>	<u>\$ 32,461</u>	<u>\$ 3,902</u>	<u>\$ 4,333</u>
Excess of Revenues Over (Under) Expenditures	<u>\$ (13,407)</u>	<u>\$ (14,264)</u>	<u>\$ (15,648)</u>	<u>\$ (24,054)</u>	<u>\$ 1,659</u>	<u>\$ 791</u>
OTHER FINANCING SOURCES						
Transfers in:						
From Game and Fish Protection Trust Fund	\$ 10,615	\$ 10,696	\$	\$	\$	\$
Gas tax from Michigan Transportation Fund			14,737	14,748		
From Department of Environmental Quality's Natural Resources Damages Fund	485					
Total Other Financing Sources	<u>\$ 11,100</u>	<u>\$ 10,696</u>	<u>\$ 14,737</u>	<u>\$ 14,748</u>	<u>\$ 0</u>	<u>\$ 0</u>
OTHER FINANCING USES						
Transfers out:						
To General Fund for other departments' services provided	\$ (901)	\$ (1,608)	\$ (291)	\$ (386)	\$ (1,169)	\$ (1,128)
To General Fund for budgetary savings						
To other DNR funds						
Total Other Financing Uses	<u>\$ (901)</u>	<u>\$ (1,608)</u>	<u>\$ (291)</u>	<u>\$ (386)</u>	<u>\$ (1,169)</u>	<u>\$ (1,128)</u>
Total Other Financing Sources (Uses)	<u>\$ 10,198</u>	<u>\$ 9,088</u>	<u>\$ 14,446</u>	<u>\$ 14,362</u>	<u>\$ (1,169)</u>	<u>\$ (1,128)</u>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	<u>\$ (3,208)</u>	<u>\$ (5,176)</u>	<u>\$ (1,202)</u>	<u>\$ (9,692)</u>	<u>\$ 490</u>	<u>\$ (337)</u>
Fund Balances - Beginning of fiscal year	<u>29,453</u>	<u>34,629</u>	<u>38,070</u>	<u>47,761</u>	<u>521</u>	<u>859</u>
Fund Balances - End of fiscal year	<u>\$ 26,245</u>	<u>\$ 29,453</u>	<u>\$ 36,868</u>	<u>\$ 38,070</u>	<u>\$ 1,011</u>	<u>\$ 521</u>

Game and Fish Protection Trust Fund		State Park Improvement Fund		Combined Recreation Bond Fund - Local Projects		Michigan Nongame Fish and Wildlife Fund		Forest Development Fund		Totals	
2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$ 329	\$ 282
							1	6	51	2,300	1,642
										10,483	9,647
		21,843	19,019							21,843	19,019
						1	4			49,421	48,304
		13,168	12,495							13,168	12,495
		1,433	1,385					1	1	3,371	3,100
3,455	4,860	164	85	83	90	292	304	490	134	6,348	6,475
3,866	17					(39)	(39)			3,791	(57)
4,402	4,029		19					32,793	27,187	38,019	31,475
6,168	4,706									6,231	4,795
	1	87	1,032	66		252	246	89	159	3,113	3,698
\$ 17,891	\$ 13,612	\$ 36,696	\$ 34,035	\$ 149	\$ 90	\$ 507	\$ 515	\$ 33,380	\$ 27,531	\$ 158,417	\$ 140,874
\$	\$	\$ 34,442	\$ 32,207	\$ 1,002	\$ 2,934	\$ 651	\$ 563	\$ 27,936	\$ 22,231	\$ 150,265	\$ 146,130
19	163			50		4	5			80	170
		1,374	4,069					483	484	12,805	18,974
\$ 19	\$ 163	\$ 35,815	\$ 36,277	\$ 1,052	\$ 2,934	\$ 654	\$ 568	\$ 28,418	\$ 22,716	\$ 163,150	\$ 165,274
\$ 17,871	\$ 13,449	\$ 880	\$ (2,241)	\$ (903)	\$ (2,844)	\$ (147)	\$ (53)	\$ 4,962	\$ 4,816	\$ (4,733)	\$ (24,400)
\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$ 10,615	\$ 10,696
										14,737	14,748
										485	0
\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 25,837	\$ 25,444
\$ (13)	\$ (10)	\$ (1,309)	\$ (1,269)	\$ (3)	\$ (5)	\$ (3)	\$ (3)	\$ (1,122)	\$ (834)	\$ (4,810)	\$ (5,243)
					(559)						(559)
(10,615)	(10,696)									(10,615)	(10,696)
\$ (10,627)	\$ (10,706)	\$ (1,309)	\$ (1,269)	\$ (3)	\$ (564)	\$ (3)	\$ (3)	\$ (1,122)	\$ (834)	\$ (15,424)	\$ (16,497)
\$ (10,627)	\$ (10,706)	\$ (1,309)	\$ (1,269)	\$ (3)	\$ (564)	\$ (3)	\$ (3)	\$ (1,122)	\$ (834)	\$ 10,413	\$ 8,947
\$ 7,244	\$ 2,743	\$ (428)	\$ (3,510)	\$ (906)	\$ (3,407)	\$ (150)	\$ (56)	\$ 3,840	\$ 3,982	\$ 5,679	\$ (15,453)
98,111	95,368	5,805	9,316	2,934	6,341	6,451	6,507	11,173	7,191	192,518	207,972
\$ 105,355	\$ 98,111	\$ 5,377	\$ 5,805	\$ 2,028	\$ 2,934	\$ 6,301	\$ 6,451	\$ 15,013	\$ 11,173	\$ 198,197	\$ 192,518

Descriptions of Permanent Funds

MICHIGAN NATURAL RESOURCES TRUST FUND

The State Constitution was amended in 1984 to provide for the Michigan Natural Resources Trust Fund. The Fund, established in 1985, operates under Part 19, Act 451, P.A. 1994, as amended. Most rentals, royalties, and other revenues derived from mineral, coal, oil, and gas interests on State-owned land are credited to the Fund. Act 451, P.A. 1994, directs a portion (50%, up to \$10 million per year) of these revenues to the Michigan State Parks Endowment Fund. The voters approved a constitutional amendment in August 2002 that increased the amount that can be accumulated to \$500 million, changed the distribution formula, and allows the State Treasurer to invest in equity securities and other types of investments.

In accordance with statutory provisions, this Fund is to accumulate up to \$500 million in reserves for permanent investments. The amount accumulated toward this cap is shown as a reservation of fund balance. Interest and investment earnings and one-third of royalty earnings are available for appropriation. Two-thirds of royalty earnings, less the portion transferred to the Michigan State Parks Endowment Fund, are added to amounts held for permanent investments until the investment reserve reaches \$500 million. After that time, all royalties are transferred to the Michigan State Parks Endowment Fund, and only the interest and investment earnings are available for appropriation. Appropriations are used to fund grants to local units of government and State agencies to acquire land or develop outdoor public recreation facilities and make payments in lieu of property taxes on State lands acquired by the Fund.

MICHIGAN STATE PARKS ENDOWMENT FUND

This Fund was established in 1994 and operates under Part 741, Act 451, P.A. 1994, as amended, to finance operations, maintenance, and capital improvements at State parks. The voters approved a constitutional amendment in August 2002 that changed the distribution formula and allows the State Treasurer to invest in equity securities and other types of investments.

The Fund was established with a \$40 million transfer from the sale of the Accident Fund of Michigan to provide funds for permanent investment. By statute, up to \$10 million per year of revenues from oil and gas bonuses, rentals, and royalties from State-owned land are to be deposited in this Fund until the Michigan Natural Resources Trust Fund reaches an accumulated principal of \$500 million, after which time all revenue

previously going to the Michigan Natural Resources Trust Fund will go to the Michigan State Parks Endowment Fund. The Fund's investment reserve will be capped at \$800 million. Part 19, Act 451, P.A. 1994, limits the Legislature to appropriating no more than 50% of the amount transferred from the Michigan Natural Resources Trust Fund plus interest and investment earnings. When the Fund's reserve reaches \$800 million, only the interest and earnings in excess of the amount needed to maintain the \$800 million principal limit may be expended.

MICHIGAN CIVILIAN CONSERVATION CORPS ENDOWMENT FUND

This Fund was established by Act 394, P.A. 1994, as amended. The Michigan Civilian Conservation Corps was established for the purpose of conserving, improving, and developing the State's natural resources and for enhancing, preserving, and maintaining public lands and waters through the employment of residents of this State in work training programs. The Fund's permanent investment reserve was provided by \$20 million earmarked from the sale of the Accident Fund of Michigan. Only the interest and investment earnings of the Fund can be expended.

DEPARTMENT OF NATURAL RESOURCES
Combining Balance Sheet
Permanent Funds
As of September 30
(In Thousands)

	Michigan Natural Resources Trust Fund		Michigan State Parks Endowment Fund		Michigan Civilian Conservation Corps Endowment Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
ASSETS								
Cash	\$	\$	\$ 1	\$	\$	\$	\$ 1	\$
Equity in common cash	121,461	177,735	18,654	69,406	619	6,785	140,733	253,926
Securities lending collateral	4,262	4,948	2,213	5,541	3,615	1,020	10,090	11,508
Other current assets	12,299	8,186	1,057	315	194	79	13,549	8,580
Investments - Long-term	249,696	170,512	111,438	72,494	19,185	13,527	380,319	256,533
Total Assets	\$ 387,718	\$ 361,380	\$ 133,362	\$ 147,756	\$ 23,613	\$ 21,412	\$ 544,692	\$ 530,547
LIABILITIES AND FUND BALANCES								
Liabilities:								
Warrants outstanding	\$ 180	\$ 80	\$ 66	\$ 92	\$ 3	\$ 18	\$ 249	\$ 191
Accounts payable and other liabilities	2,379	28,515	924	13,032	57	94	3,360	41,641
Obligations under security lending	4,262	4,948	2,213	5,541	3,615	1,020	10,090	11,508
Amounts due to other funds	14	11	41	32	2	2	57	45
Deferred revenue - Current	3,384						3,384	0
Total Liabilities	\$ 10,219	\$ 33,553	\$ 3,244	\$ 18,697	\$ 3,677	\$ 1,135	\$ 17,140	\$ 53,385
Fund Balances:								
Reserves for:								
Budgetary carry-forwards:								
Encumbrances	\$ 21,548	\$ 11,005	\$ 1,710	\$ 2,264	\$	\$	\$ 23,258	\$ 13,269
Multi-year projects	32,786	34,320	193	3,422			32,979	37,743
Funds held as permanent investments	289,044	250,729	117,362	112,499	19,586	19,904	425,993	383,132
Total Reserved	\$ 343,377	\$ 296,055	\$ 119,266	\$ 118,185	\$ 19,586	\$ 19,904	\$ 482,229	\$ 434,144
Unreserved	34,122	31,773	10,852	10,874	349	372	45,323	43,019
Total Fund Balances	\$ 377,499	\$ 327,827	\$ 130,118	\$ 129,058	\$ 19,936	\$ 20,277	\$ 527,552	\$ 477,163
Total Liabilities and Fund Balances	\$ 387,718	\$ 361,380	\$ 133,362	\$ 147,756	\$ 23,613	\$ 21,412	\$ 544,692	\$ 530,547

DEPARTMENT OF NATURAL RESOURCES
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Permanent Funds
Fiscal Years Ended September 30
(In Thousands)

	Michigan Natural Resources Trust Fund		Michigan State Parks Endowment Fund		Michigan Civilian Conservation Corps Endowment Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
REVENUES								
Miscellaneous:								
Interest and investment revenue	\$ 12,742	\$ 14,741	\$ 5,129	\$ 6,826	\$ 1,011	\$ 1,050	\$ 18,882	\$ 22,617
Unrealized gain(loss) on investments	3,924	(6,012)	1,753	(1,756)	(318)	(361)	5,359	(8,129)
Oil, gas, and mineral royalties	66,607	50,963					66,607	50,963
Other miscellaneous revenue	157	14	1	1			158	15
Total Revenues	<u>\$ 83,430</u>	<u>\$ 59,705</u>	<u>\$ 6,883</u>	<u>\$ 5,071</u>	<u>\$ 693</u>	<u>\$ 690</u>	<u>\$ 91,006</u>	<u>\$ 65,466</u>
EXPENDITURES								
Current	\$ 2,536	\$ 2,578	\$ 12,498	\$ 10,705	\$ 974	\$ 905	\$ 16,009	\$ 14,188
General government	201	402	80	206	56	38	337	646
Capital outlay projects	21,216	15,723	3,175	1,680			24,391	17,403
Total Expenditures	<u>\$ 23,954</u>	<u>\$ 18,702</u>	<u>\$ 15,752</u>	<u>\$ 12,591</u>	<u>\$ 1,030</u>	<u>\$ 943</u>	<u>\$ 40,736</u>	<u>\$ 32,236</u>
Excess of Revenues Over (Under) Expenditures	<u>\$ 59,476</u>	<u>\$ 41,003</u>	<u>\$ (8,869)</u>	<u>\$ (7,520)</u>	<u>\$ (337)</u>	<u>\$ (253)</u>	<u>\$ 50,270</u>	<u>\$ 33,230</u>
OTHER FINANCING SOURCES								
Proceeds from sale of capital assets	\$ 245	\$ 5,286	\$	\$	\$	\$	\$ 245	\$ 5,286
Transfers in:								
Oil and gas royalties from the Michigan Natural Resources Trust Fund			10,000	10,000			10,000	10,000
Total Other Financing Sources	<u>\$ 245</u>	<u>\$ 5,286</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 10,245</u>	<u>\$ 15,286</u>
OTHER FINANCING USES								
Transfers out:								
To General Fund for other departments' services provided	\$ (49)	\$ (34)	\$ (71)	\$ (25)	\$ (4)	\$ (5)	\$ (125)	\$ (64)
To Michigan State Parks Endowment Fund	(10,000)	(10,000)					(10,000)	(10,000)
Total Other Financing Uses	<u>\$ (10,049)</u>	<u>\$ (10,034)</u>	<u>\$ (71)</u>	<u>\$ (25)</u>	<u>\$ (4)</u>	<u>\$ (5)</u>	<u>\$ (10,125)</u>	<u>\$ (10,064)</u>
Total Other Financing Sources (Uses)	<u>\$ (9,804)</u>	<u>\$ (4,748)</u>	<u>\$ 9,929</u>	<u>\$ 9,975</u>	<u>\$ (4)</u>	<u>\$ (5)</u>	<u>\$ 120</u>	<u>\$ 5,221</u>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	<u>\$ 49,672</u>	<u>\$ 36,255</u>	<u>\$ 1,059</u>	<u>\$ 2,455</u>	<u>\$ (341)</u>	<u>\$ (258)</u>	<u>\$ 50,390</u>	<u>\$ 38,451</u>
Fund Balances - Beginning of fiscal year	<u>327,827</u>	<u>291,572</u>	<u>129,058</u>	<u>126,604</u>	<u>20,277</u>	<u>20,535</u>	<u>477,163</u>	<u>438,711</u>
Fund Balances - End of fiscal year	<u><u>\$ 377,499</u></u>	<u><u>\$ 327,827</u></u>	<u><u>\$ 130,118</u></u>	<u><u>\$ 129,058</u></u>	<u><u>\$ 19,936</u></u>	<u><u>\$ 20,277</u></u>	<u><u>\$ 527,552</u></u>	<u><u>\$ 477,163</u></u>

Description of Capital Projects Fund

COMBINED RECREATION BOND FUND - STATE PROJECTS

This Fund was established in 1988 and operates under Parts 196, 715, and 741, Act 451, P.A. 1994, as amended. The balances in the Fund reflect proceeds and investment earnings remaining from three bond packages. The first bond package was \$70 million of general obligation bonds approved by voters in November 1988 as part of a \$140 million bond package for financing State and local public recreation projects. The second bond package was \$50 million of general obligation bonds approved by voters in November 1998 as part of a \$675 million bond package known as the "Clean Michigan Initiative." The third bond package was \$15.5 million of State Park Gross Revenue Bonds issued in September 2002.

The proceeds from the 1988 bond package were used to construct, expand, and develop recreational facilities at State parks. The proceeds from the 1998 bond package were used for infrastructure improvements at State parks. The proceeds from the 2002 bond package were used to finance a major renovation of the Sterling State Park.

The capital projects fund's financial statements are presented as a part of the governmental fund types, combined financial statements on pages 14 and 15.

DEPARTMENT OF NATURAL RESOURCES
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005

		For the Fiscal Year Ended September 30, 2004		
Federal Agency/Program	CFDA (2) Number	Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Agriculture</u>				
Direct Programs:				
Plant and Animal Disease, Pest Control, and Animal Care	10.025	\$ 71,248	\$	\$ 71,248
Conservation Reserve Program	10.069	35,763		35,763
Cooperative Forestry Assistance	10.664	1,867,834	1,289,035	3,156,869
Schools and Roads - Grants to States	10.665		2,652,193	2,652,193
Forest Legacy Program	10.676			0
Forest Land Enhancement Program	10.677			0
Total U.S. Department of Agriculture		\$ 1,974,845	\$ 3,941,228	\$ 5,916,073
<u>U.S. Department of Commerce</u>				
Direct Program:				
Interjurisdictional Fisheries Act of 1986	11.407	\$ 7,974	\$	\$ 7,974
Total U.S. Department of Commerce		\$ 7,974	\$ 0	\$ 7,974
<u>U.S. Department of the Interior</u>				
Fish and Wildlife Cluster:				
Direct Programs:				
Sport Fish Restoration	15.605	\$ 7,523,761	\$	\$ 7,523,761
Wildlife Restoration	15.611	6,973,111		6,973,111
Total Fish and Wildlife Cluster		<u>\$ 14,496,872</u>	<u>\$ 0</u>	<u>\$ 14,496,872</u>
Direct Programs:				
Cooperative Endangered Species Conservation Fund	15.615	\$ 364,427	\$	\$ 364,427
Clean Vessel Act	15.616	4,947	22,839	27,786
Sportfishing and Boating Safety Act	15.622			0
Wildlife Conservation and Restoration	15.625	212,997		212,997
Landowner Incentive	15.633	319,146		319,146
State Wildlife Grants	15.634	1,754,807		1,754,807
Gap Analysis Program	15.811	5,242		5,242
Outdoor Recreation - Acquisition, Development and Planning	15.916	315,819	1,013,578	1,329,397
Endangered Species	15.301810J068 (3)	2,220		2,220
Total Direct Programs		<u>\$ 2,979,605</u>	<u>\$ 1,036,417</u>	<u>\$ 4,016,022</u>
Total U.S. Department of the Interior		\$ 17,476,477	\$ 1,036,417	\$ 18,512,894
<u>U.S. Department of Justice</u>				
Pass-Through Programs:				
Michigan Department of State Police (4 and 5)				
State and Local Domestic Preparedness Equipment Support Program	16.007	\$ 2,078	\$	\$ 2,078
Urban Area Security Initiative	16.011			0
Total U.S. Department of Justice		\$ 2,078	\$ 0	\$ 2,078

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 89,286	\$	\$ 89,286	\$ 160,534
649		649	36,412
1,475,779	1,540,349	3,016,128	6,172,997
	2,451,612	2,451,612	5,103,805
27,005		27,005	27,005
48,913		48,913	48,913
\$ 1,641,632	\$ 3,991,961	\$ 5,633,593	\$ 11,549,666
\$ 15,035	\$	\$ 15,035	\$ 23,009
\$ 15,035	\$ 0	\$ 15,035	\$ 23,009
\$ 8,848,061	\$	\$ 8,848,061	\$ 16,371,822
9,179,192		9,179,192	16,152,303
\$ 18,027,253	\$ 0	\$ 18,027,253	\$ 32,524,125
\$ 332,451	\$	\$ 332,451	\$ 696,878
9,235	28,657	37,892	65,678
161,090		161,090	161,090
2,353		2,353	215,350
556,289		556,289	875,435
2,799,351		2,799,351	4,554,158
		0	5,242
1,861,813	2,303,846	4,165,659	5,495,056
		0	2,220
\$ 5,722,582	\$ 2,332,503	\$ 8,055,085	\$ 12,071,107
\$ 23,749,835	\$ 2,332,503	\$ 26,082,338	\$ 44,595,232
\$ 31,637	\$	\$ 31,637	\$ 33,715
99,908		99,908	99,908
\$ 131,545	\$ 0	\$ 131,545	\$ 133,623

DEPARTMENT OF NATURAL RESOURCES
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005
Continued

		For the Fiscal Year Ended September 30, 2004		
Federal Agency/Program	CFDA (2) Number	Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Transportation</u>				
Direct Program:				
Recreational Trails Program	20.219	\$ 607,349	\$ 948,108	\$ 1,555,457
Total U.S. Department of Transportation		\$ 607,349	\$ 948,108	\$ 1,555,457
<u>U.S. Environmental Protection Agency</u>				
Direct Program:				
Great Lakes Program	66.469	\$ 11,998	\$	\$ 11,998
Total U.S. Environmental Protection Agency		\$ 11,998	\$ 0	\$ 11,998
<u>Federal Emergency Management Administration</u>				
Pass-Through Programs:				
Michigan Department of State Police (4 and 5)				
Public Assistance Grants	83.544	\$ 4,073	\$	\$ 4,073
Hazard Mitigation Grant	83.548	91,911		91,911
Total Federal Emergency Management Administration		\$ 95,984	\$ 0	\$ 95,984
<u>U.S. Department of Homeland Security</u>				
Direct Program:				
Boating Safety Financial Assistance	97.012	\$ 2,413,521	\$	\$ 2,413,521
Total U.S. Department of Homeland Security		\$ 2,413,521	\$ 0	\$ 2,413,521
Total Federal Expenditures		\$ 22,590,226	\$ 5,925,753	\$ 28,515,979

(1) Basis of Presentation: This schedule of expenditures of federal awards includes the federal grant activity of the Department of Natural Resources (DNR) and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements and financial schedules.

(2) CFDA is defined as *Catalog of Federal Domestic Assistance*.

(3) CFDA number not available. Number derived from federal agency number and grant or contract number, if available.

(4) DNR receives some federal grants as a subgrantee of another State department. In these cases, the transfer of the financing is recorded in the DNR accounting records as an expenditure credit.

(5) The pass-through entity did not provide DNR with pass-through identification numbers.

<u>For the Fiscal Year Ended September 30, 2005</u>			Total Expended and Distributed for the Two-Year Period
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	
\$ 1,160,644	\$	\$ 1,160,644	\$ 2,716,101
\$ 1,160,644	\$ 0	\$ 1,160,644	\$ 2,716,101
\$ 6,985	\$	\$ 6,985	\$ 18,983
\$ 6,985	\$ 0	\$ 6,985	\$ 18,983
\$ 25,989	\$	\$ 25,989	\$ 30,062
113,570		113,570	205,481
\$ 139,559	\$ 0	\$ 139,559	\$ 235,543
\$ 2,644,805	\$	\$ 2,644,805	\$ 5,058,326
\$ 2,644,805	\$ 0	\$ 2,644,805	\$ 5,058,326
<u>\$ 29,490,040</u>	<u>\$ 6,324,464</u>	<u>\$ 35,814,504</u>	<u>\$ 64,330,483</u>

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Keith J. Charters, Chair
Natural Resources Commission
and
Ms. Rebecca A. Humphries, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the financial statements and financial schedules of the Department of Natural Resources as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents, and have issued our report thereon dated April 19, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and financial schedules and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements and financial schedules. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 1 through 5.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements and financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions identified in the previous paragraph is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements and financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement and financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Natural Resources Commission, the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.
Auditor General
April 19, 2006



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
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LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

Mr. Keith J. Charters, Chair
Natural Resources Commission
and
Ms. Rebecca A. Humphries, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

Compliance

We have audited the compliance of the Department of Natural Resources with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2005. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of Natural Resources complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 6 through 9.

Internal Control Over Compliance

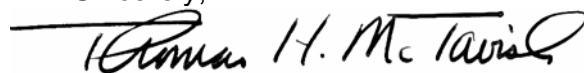
The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 6 through 10.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions identified in the previous paragraph is a material weakness.

This report is intended solely for the information and use of the Natural Resources Commission, the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas H. McTavish", with a stylized flourish at the end.

Thomas H. McTavish, C.P.A.
Auditor General
April 19, 2006

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Statements and Financial Schedules

Type of auditor's report issued: Unqualified*

Internal control* over financial reporting:

Material weaknesses* identified? No

Reportable conditions* identified that are not considered to be material weaknesses? Yes

Noncompliance or other matters material to the financial statements and/or financial schedules? No

Federal Awards

Internal control over major programs:

Material weaknesses identified? No

Reportable conditions identified that are not considered to be material weaknesses? Yes

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)? Yes

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.664	Cooperative Forestry Assistance
10.665	Schools and Roads - Grants to States
15.605 and 15.611	Fish and Wildlife Cluster
15.634	State Wildlife Grants

* See glossary at end of report for definition.

15.916 Outdoor Recreation - Acquisition,
Development and Planning

97.012 Boating Safety Financial Assistance

Dollar threshold used to distinguish between type A and type B programs: \$1,929,915

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Statements and Financial Schedules

FINDING (750601)

1. Retail Sales System Controls

The Department of Natural Resources' (DNR's) controls for the retail sales of licenses did not minimize the risk of fraud or misuse of voided licenses.

Because a potential for fraud or misuse exists when licenses are voided, DNR should implement procedures to review voided licenses at least on a test basis.

DNR contracts with sales agents throughout the State to sell hunting, fishing, trapping, and off-road vehicle licenses using the automated Retail Sales System. In fiscal year 2004-05, DNR sales agents sold approximately 4.6 million licenses totaling \$53.4 million.

DNR requires sales agents to submit voided licenses to the central office. However, DNR did not verify that all voided licenses were submitted and did not review the voided licenses to ensure their propriety. For fiscal year 2004-05, sales agents voided 138,676 (3.0%) licenses totaling approximately \$1.7 million.

In response to a similar Finding in the prior audit report, DNR indicated that it concurred with the finding and would comply with the corresponding recommendation.

* See glossary at end of report for definition.

RECOMMENDATION

WE AGAIN RECOMMEND THAT DNR IMPROVE ITS CONTROLS FOR RETAIL SALES OF LICENSES TO MINIMIZE THE RISK OF FRAUD OR MISUSE OF VOIDED LICENSES.

FINDING (750602)

2. Service Organization Controls

DNR did not obtain sufficient assurances regarding the internal control of the service organizations that operated the Retail Sales System and the Central Reservation System. As a result, DNR could not ensure that receipts were properly safeguarded and completely processed.

The Retail Sales System is used to process revenues related to hunting, fishing, and trapping licenses; snowmobile trail fees; and off-road vehicle licenses. The Central Reservation System is used to process camping fees. The Retail Sales System and the Central Reservation System processed approximately \$49.4 million and \$21.8 million, respectively, of revenue in fiscal year 2004-05.

Section 18.1485 of the *Michigan Compiled Laws* requires that each department establish and maintain an internal accounting and administrative control system for the management of its financial affairs, including internal control techniques that are effective and efficient. Inherent in this requirement is DNR's responsibility to ensure that its service organizations have proper, effective, and operational controls over the processes performed for DNR. Several alternatives exist for DNR to obtain necessary assurances regarding the internal control, including developing compensating controls within DNR to minimize the risk at the service organization, conducting an audit or evaluation at the service organization, or employing an independent auditor to conduct a review (typically in accordance with the American Institute of Certified Public Accountants Statement on Auditing Standards No. 70, *Service Organizations*).

RECOMMENDATION

We recommend that DNR obtain sufficient assurances regarding the internal control of the service organizations that operate the Retail Sales System and the Central Reservation System.

FINDING (750603)

3. Controls Over Accounts Payable

DNR's controls over recording accounts payable for the Michigan Natural Resources Trust Fund (MNRTF) and General Fund expenditures did not ensure that expenditures were recorded in the proper fiscal year. As a result, accounts payable and expenditures were misstated in both MNRTF and the General Fund.

Our review disclosed that fiscal year 2004-05 MNRTF expenditures are overstated and fiscal year 2003-04 MNRTF expenditures are understated by \$1,313,163 and \$1,464,890, respectively. In addition, MNRTF accounts payable are understated in fiscal years 2004-05 and 2003-04 by \$461,887 and \$1,775,050, respectively. Fiscal year 2004-05 General Fund expenditures and accounts payable are understated by \$92,691. Fiscal year 2003-04 General Fund expenditures are overstated by \$255,785.

Sections 1600.116 through 1600.119 of the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the Governmental Accounting Standards Board, provide that government should accrue governmental fund liabilities and expenditures in the period in which the government incurs the liability. Chapter 14, Section 100 of the State of Michigan Financial Management Guide provides that accounts payable may be recorded on an actual or, if necessary, estimated basis. All accounts payable must be recorded by the date specified in the year-end closing schedule.

Our review of 13 MNRTF expenditure transactions totaling \$5,080,116 and 33 General Fund expenditure transactions totaling \$2,466,317 disclosed:

- a. Seven MNRTF expenditure transactions totaling \$2,547,100 were not recorded in the proper fiscal year. DNR requested information on estimated accounts payable from the grantees in August of each fiscal year. None of the grantees for the 7 expenditure transactions responded to DNR's request by the September 15 deadline; therefore, DNR did not record estimated payables for these grantees. However, our review disclosed that all of the grantees submitted reimbursement requests to DNR prior to the deadline for recording accounts payable.

- b. Seven General Fund expenditure transactions totaling \$412,705 were not recorded in the proper fiscal year. DNR requested information on estimated accounts payable from the grantees in August of each fiscal year. Six (86%) of the 7 grantees for the 7 expenditure transactions had not responded to DNR's request by the September 15 deadline; therefore, DNR did not record estimated payables for these grantees. The grantee that responded reported expenditures that were incurred in the current fiscal year and in the previous fiscal year. Historically, grantees of this program incur expenditures over a period of multiple fiscal years and generally only request reimbursement four times over the life of the grant. DNR has not developed a methodology to estimate accounts payable based on historical trends.

RECOMMENDATION

We recommend that DNR improve its controls over recording accounts payable for MNRTF and General Fund expenditures to ensure that expenditures are recorded in the proper fiscal year.

FINDING (750604)

4. Cash Management

DNR's controls did not ensure compliance with federal and State cash management standards. Noncompliance with these standards resulted in the State losing approximately \$122,600 in interest income.

DNR's drawdowns of federal funds are to be made in accordance with Section 18.1395(5) of the *Michigan Compiled Laws* and Department of Management and Budget (DMB) Administrative Guide procedure 1210.06. The *Michigan Compiled Laws* and DMB standards require DNR to use State General Fund/general purpose appropriations only after the available restricted funds have been used. The federal and DMB standards also require DNR to minimize the time elapsing between the transfer of funds from the U.S. Department of Treasury and the pay out of funds by the State.

Our review of the Cooperative Forestry Assistance and the State Wildlife Grant Programs disclosed:

- a. In the Cooperative Forestry Assistance Program, DNR expended approximately \$5.7 million and drew down approximately \$3.7 million in federal revenue between October 1, 2003 and September 30, 2005. We estimated that the lack of timely drawdowns resulted in the State losing interest income of approximately \$36,700 and \$12,900 in fiscal years 2004-05 and 2003-04, respectively, based on the State Treasurer's Common Cash rate of return.
- b. In the State Wildlife Grant Program, DNR expended approximately \$4.4 million and drew down \$2.3 million in federal revenue between October 1, 2003 and September 30, 2005. We estimated that the lack of timely drawdowns resulted in the State losing interest income of approximately \$66,600 and \$6,400 in fiscal years 2004-05 and 2003-04, respectively, based on the State Treasurer's Common Cash rate of return.

RECOMMENDATION

We recommend that DNR strengthen its controls to ensure compliance with federal and State cash management standards.

FINDING (750605)

5. Monitoring of Gas Royalty Revenue

DNR, in coordination with DMB, needs to strengthen its controls to ensure compliance with provisions of the State's gas royalty revenue agreements with a third party purchaser. As a result, DNR overstated oil, gas, and mineral royalties revenue and understated liabilities by \$6.8 million in fiscal year 2004-05.

In 1997, DNR and DMB entered into a purchase and sale agreement with a third party purchaser that sold royalty revenue interests to the third party purchaser in order to take advantage of federal tax credits under Section 29 of the Internal Revenue Code. DNR and DMB also entered into a servicing agreement that stated that DNR and DMB would manage the royalty revenue interests on behalf of the buyer.

The purchase and sale agreement indicated that, when the production from approximately 2,700 gas wells reached 57.0 billion cubic feet, all of the revenue from royalty interests would be forwarded to the buyer and, when the total production reached 67.3 billion cubic feet, all of the revenue from royalty interests would revert back to the State.

Per the service agreement, DNR and DMB were assigned the responsibilities for providing reports that included revenue details and for monitoring the gas well production levels to determine when the production reached 57.0 billion cubic feet. Because neither DNR nor DMB had all of the data necessary to fulfill these responsibilities internally, independent firms were hired to perform the monitoring functions and prepare the related reports. DNR provided revenue details to the independent firms until the contract with the last firm expired in August 2004, then DNR provided revenue details to the third party purchaser directly. However, the specific reports monitoring production levels were not provided by DNR, DMB, or an independent firm from August 2004 through September 2005.

In October 2005, DMB contracted with an independent firm to resume preparing the revenue and production level reports. The firm's February 2006 report indicated that the 57.0 billion cubic feet production level had been reached in June 2005 and that DNR should have forwarded \$6.8 million of gas royalty revenue to the third party purchaser between July 1, 2005 and September 30, 2005. DNR did not identify this liability until after the fiscal year 2004-05 accounting records were closed and, therefore, did not record a liability in the accounting records. DNR has disclosed this situation in the notes to the financial statements (Note 4).

RECOMMENDATION

We recommend that DNR, in coordination with DMB, strengthen its controls to ensure compliance with provisions of the State's gas royalty revenue agreements with a third party purchaser.

The status of the findings related to the financial statements and financial schedules that were reported in prior Single Audits* is disclosed in the summary schedule of prior audit findings.

* See glossary at end of report for definition.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (750606)

6. Cooperative Forestry Assistance, CFDA 10.664

U.S. Department of Agriculture	CFDA 10.664: Cooperative Forestry Assistance
Grant Agreement Numbers:	Award Periods:
03-DG-11244225-268	10/01/2002 - 09/30/2006
03-DG-11244225-269	10/01/2002 - 09/30/2005
03-DG-11244225-568	10/01/2002 - 09/30/2006
04-DG-11244225-046	10/01/2003 - 09/30/2005
	Questioned Costs: \$0

DNR's controls over the Cooperative Forestry Assistance Program did not ensure compliance with federal laws and regulations regarding reporting and subrecipient* monitoring.

Controls that do not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Cooperative Forestry Assistance Program.

Our review of expenditures and program files disclosed:

a. Reporting

DNR's controls did not ensure compliance with federal laws and regulations regarding performance reports.

Title 7, Part 3016, sections 40 (b) (1) and (2) of the *Code of Federal Regulations (CFR)* require that performance reports must be submitted comparing actual results to planned objectives for the grant period.

The fiscal year 2003-04 Volunteer Fire Assistance Grant performance report indicated that the federal funds were expended to fund 74 applications totaling \$268,185. These applications were approved, awarded, and completed in fiscal year 2004-05. Our review disclosed that DNR had not established

* See glossary at end of report for definition.

accounting system coding to differentiate between federal grant periods. As a result, the \$268,185 reported for the fiscal year 2003-04 grant may have been funded with fiscal year 2003-04 grant funds or with fiscal year 2004-05 grant funds.

b. Subrecipient Monitoring

DNR's controls did not ensure that it satisfied the pass-through entity responsibilities as established by OMB Circular A-133.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients that carry out federal programs. DNR distributed approximately \$1.5 million and \$1.3 million to Cooperative Forestry Assistance Program subrecipients in fiscal years 2004-05 and 2003-04, respectively.

Our review of the grant award notifications and program files disclosed that DNR had not informed 8 of the 12 subrecipients in our sample of all required federal grant information. OMB Circular A-133 requires pass-through entities to identify federal awards by informing each subrecipient of the *Catalog of Federal Domestic Assistance (CFDA)* title and number; award name and number; award year; name of the federal awarding agency; whether the award is for research and development; and requirements imposed on subrecipients by federal laws, regulations, and the provisions of contracts or grant agreements. The information missing from the award notifications included *CFDA* title and number, award name, and requirements imposed by federal regulations.

In addition, DNR controls did not identify which subrecipients were required to have a Single Audit performed and did not ensure that the subrecipients' Single Audit reports received included all required information (see Finding 8).

RECOMMENDATION

We recommend that DNR strengthen its controls over the Cooperative Forestry Assistance Program to ensure compliance with federal laws and regulations regarding reporting and subrecipient monitoring.

FINDING (750607)

7. Outdoor Recreation - Acquisition, Development and Planning, CFDA 15.916

U.S. Department of the Interior	CFDA 15.916: Outdoor Recreation - Acquisition, Development and Planning
Grant Agreement Numbers: 26-01570 26-01572 26-01582 26-01584 26-01596 26-01600 26-01603	Award Periods: 03/05/2002 - 12/13/2007 04/23/2003 - 12/31/2007 06/19/2002 - 12/31/2007 04/23/2002 - 12/31/2007 07/23/2003 - 12/31/2008 07/10/2003 - 12/31/2008 08/04/2003 - 12/31/2008
	Questioned Costs: \$0

DNR's controls over the Outdoor Recreation - Acquisition, Development and Planning Program did not ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

Controls that do not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Outdoor Recreation - Acquisition, Development and Planning Program.

Our review of expenditures and grant award files disclosed:

a. Reporting

DNR's controls did not ensure compliance with the federal laws and regulations regarding postcompletion inspection reports.

The Land and Water Conservation Fund Manual requires that postcompletion inspection reports be submitted to the National Park Service within five years after the final billing for a project and every five years, thereafter.

DNR had not established a system to track the status of projects so that it could determine when postcompletion inspection reports were last performed or when they were due. DNR relies on the federal system to notify it of when reports become overdue. By using DNR's data entry sheets for the federal system, we determined that DNR reported that it had conducted 164 and 20 postcompletion inspection reports in fiscal years 2004-05 and 2003-04,

respectively. By using the federal system's grants due and overdue for inspection report, we determined that 922 and 914 reports were overdue at the end of fiscal years 2004-05 and 2003-04, respectively.

b. Subrecipient Monitoring

DNR's controls did not ensure that it satisfied the pass-through entity responsibilities as established by OMB Circular A-133.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients that carry out federal programs. DNR distributed approximately \$2.3 million and \$1.0 million to Outdoor Recreation - Acquisition, Development and Planning Program subrecipients in fiscal years 2004-05 and 2003-04, respectively.

Our review of DNR's subrecipient grant files disclosed that DNR did not inform the subrecipients of the *CFDA* title and number for federal funds passed through to the subrecipients. OMB Circular A-133 requires pass-through entities to identify federal awards by informing each subrecipient of the *CFDA* title and number, award name and number, award year, name of the federal awarding agency, and whether the award is for research and development.

In addition, DNR controls did not identify which subrecipients were required to have a Single Audit performed and did not ensure that the subrecipients' Single Audit reports received included all required information (see Finding 8).

c. Special Tests and Provisions

DNR's controls did not ensure compliance with federal laws and regulations regarding the use of projects funded by the Outdoor Recreation - Acquisition, Development and Planning Program.

Title 16, Section 460I-8(f)(3) of the *United States Code* states that no property acquired or developed with assistance under the section shall, without the approval of the Secretary of the Interior, be converted to other than public outdoor recreation uses.

Conversions generally occur in the following four situations: (1) Property interests are conveyed for non-public outdoor recreation uses; (2) non-outdoor recreation uses are made of the project area or a portion thereof;

(3) noneligible indoor recreation facilities are developed within the project without National Park Service approval; or (4) public outdoor recreation use of property acquired or developed with Land and Water Conservation Fund assistance is terminated.

During our review, we noted that DNR had not developed a process to accumulate conversion data or to identify projects in conversion status. As a result, DNR could not identify which projects were going through the conversion process during fiscal years 2004-05 and 2003-04. DNR staff verbally informed us that there were three projects that completed the conversion process during fiscal years 2004-05 and 2003-04. We reviewed these three projects and noted no exceptions. However, the lack of controls designed to ensure compliance with federal laws and regulations could result in future sanctions and/or disallowances.

RECOMMENDATION

We recommend that DNR strengthen its controls over the Outdoor Recreation - Acquisition, Development and Planning Program to ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

FINDING (750608)

8. Subrecipient Monitoring

U.S. Department of Agriculture	CFDA 10.664: Cooperative Forestry Assistance
Grant Agreement Numbers: 03-DG-11244225-268 03-DG-11244225-269 03-DG-11244225-568	Award Periods: 10/01/2002 - 09/30/2006 10/01/2002 - 09/30/2005 10/01/2002 - 09/30/2006
	Questioned Costs: \$0

U.S. Department of Agriculture	CFDA 10.665: Schools and Roads - Grants to States
Grant Agreement Numbers: None	Award Periods: None
	Questioned Costs: \$0

U.S. Department of the Interior	CFDA 15.916: Outdoor Recreation - Acquisition, Development and Planning
Grant Agreement Numbers: 26-01570 26-01572 26-01582 26-01584 26-01596 26-01600 26-01603	Award Periods: 03/05/2002 - 12/13/2007 04/23/2003 - 12/31/2007 06/19/2002 - 12/31/2007 04/23/2002 - 12/31/2007 07/23/2003 - 12/31/2008 07/10/2003 - 12/31/2008 08/04/2003 - 12/31/2008
	Questioned Costs: \$0

DNR's controls over federal programs did not ensure compliance with federal laws and regulations regarding subrecipient monitoring.

Controls that do not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for federal programs.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients to carry out federal programs. Section 400(d) of OMB Circular A-133 requires that pass-through entities ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipients' fiscal year have met the audit requirements for that fiscal year.

Our review of DNR's subrecipient monitoring disclosed:

- a. DNR's controls did not identify which subrecipients were required to have a Single Audit performed. DNR had identified subrecipients to which it had granted federal funds but did not have controls established to determine which of those subrecipients would have expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our transaction samples for the Cooperative Forestry Assistance Program, the Schools and Roads - Grants to States Program, and the Outdoor Recreation - Acquisition, Development and Planning Program included payments to 22 subrecipients. DNR had not requested Single Audit reports from any of these subrecipients. Our review of OMB's Federal Audit Clearinghouse database for fiscal year 2003-04 Single Audit reports disclosed that 9 of the 22 subrecipients had submitted Single Audit reports to the Federal Audit Clearinghouse.

- b. DNR's controls over the review of subrecipient Single Audit reports did not ensure that the subrecipients' reports included all required information. We reviewed 7 Single Audit reporting packages submitted to and reviewed by DNR. We determined that 2 reporting packages were missing the independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 and the schedule of expenditures of federal awards. In addition, the schedule of expenditures of federal awards for 2 other reports did not include the expenditures for the federal program funds granted to the subrecipient by DNR. DNR had not followed up on these issues with the subrecipients or the subrecipients' independent auditors.

RECOMMENDATION

We recommend that DNR strengthen its controls over federal programs to ensure compliance with federal laws and regulations regarding subrecipient monitoring.

FINDING (750609)

9. Procurement and Suspension and Debarment

U.S. Department of Agriculture	CFDA 10.664: Cooperative Forestry Assistance
Grant Agreement Numbers: 02-DG-11244225-305 03-DG-11244225-268 03-DG-11244225-269 03-DG-11244225-568 04-DG-11244225-045 05-DG-11244225-344	Award Periods: 10/01/2001 - 09/30/2004 10/01/2002 - 09/30/2006 10/01/2002 - 09/30/2005 10/01/2002 - 09/30/2006 10/01/2003 - 09/30/2007 10/01/2004 - 09/30/2007
	Questioned Costs: \$0

U.S. Department of the Interior	CFDA 15.605 and 15.611: Sport Fish Restoration and Wildlife Restoration
Grant Agreement Numbers:	Award Periods:
Y-3-B-1	09/15/2002 - 06/30/2005
F-81-R-5	10/01/2003 - 09/30/2004
F-81-R-6	10/01/2004 - 09/30/2005
F-62-D-17	10/01/2003 - 09/30/2004
F-62-D-18	10/01/2004 - 09/30/2005
F-82-R-4	10/01/2003 - 09/30/2004
F-82-R-5	10/01/2004 - 09/30/2005
F-80-R-5	10/01/2003 - 09/30/2004
F-80-R-6	10/01/2004 - 09/30/2005
301812J260	10/03/2002 - 12/31/2005
301812J213	08/26/2002 - 12/31/2005
F-84-D-3	10/01/2003 - 09/30/2004
F-84-D-4	10/01/2004 - 09/30/2005
F-85-D-1	02/06/2002 - 09/30/2005
W-140-D-10	10/01/2003 - 09/30/2004
W-141-D-6	10/01/2003 - 09/30/2004
W-148-M-1	09/26/2004 - 09/30/2005
W-149-P-1	09/26/2004 - 09/30/2005
W-120-S-41	10/01/2003 - 09/30/2004
W-120-S-42	10/01/2004 - 09/30/2005
W-142-L-7	10/01/2003 - 09/30/2004
W-150-D-1	10/26/2004 - 09/30/2005
W-147-R-2	10/01/2003 - 09/30/2004
W-147-R-3	09/26/2004 - 09/30/2005
	Questioned Costs: \$0

U.S. Department of the Interior	CFDA 15.634: State Wildlife Grants
Award Numbers:	Award Periods:
T-1-P-1	12/01/2002 - 09/30/2003
T-1-P-2	09/19/2003 - 09/30/2005
T-1-P-3	09/16/2004 - 09/30/2005
T-2-M-1	03/15/2003 - 09/30/2003
T-2-M-2	10/01/2003 - 09/30/2004
	Questioned Costs: \$0

U.S. Department of the Interior	CFDA 15.916: Outdoor Recreation - Acquisition, Development and Planning
Grant Agreement Numbers: 26-01569 26-01589 26-01605 26-01608 26-01618 26-01620	Award Periods: 03/05/2002 - 12/31/2007 09/03/2003 - 12/31/2008 09/02/2003 - 12/31/2008 09/02/2003 - 12/31/2008 08/19/2004 - 12/31/2009 11/01/2004 - 12/31/2009
	Questioned Costs: \$0

DNR's controls over federal programs did not ensure compliance with federal laws and regulations regarding procurement and suspension and debarment.

Controls that do not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for federal programs.

The federal Common Rule (codified at federal regulations 7 *CFR* 3016.35 and 43 *CFR* 12.75) states that grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs under Executive Order 12549.

Our review of DNR's grant awarding process for the Cooperative Forestry Assistance Program disclosed that DNR did not verify that subrecipients were not on the federal List of Parties Excluded From Federal Procurement or Nonprocurement Programs.

In addition, our review of DNR's procurement process for federal programs disclosed that DNR did not verify that vendors were not on the federal List of Parties Excluded From Federal Procurement or Nonprocurement Programs.

We reviewed the federal List of Parties Excluded From Federal Procurement or Nonprocurement Programs and verified that none of the subrecipients or vendors in our samples were suspended or debarred during the respective fiscal years. As a result, we have not reported any questioned costs for this item. However, the lack of controls designed to ensure compliance with federal laws and regulations could result in future sanctions and/or disallowances.

RECOMMENDATION

We recommend that DNR strengthen its controls over federal programs to ensure compliance with federal laws and regulations regarding procurement and suspension and debarment.

FINDING (750610)

10. Cash Management

U.S. Department of Agriculture	CFDA 10.664: Cooperative Forestry Assistance
Grant Agreement Numbers:	Award Periods:
03-DG-11244225-268	10/01/2002 - 09/30/2006
03-DG-11244225-269	10/01/2002 - 09/30/2005
03-DG-11244225-568	10/01/2002 - 09/30/2006
04-DG-11244225-046	10/01/2003 - 09/30/2005
	Questioned Costs: \$0

U.S. Department of the Interior	CFDA 15.634: State Wildlife Grants
Award Numbers:	Award Periods:
T-1-P-1	12/01/2002 - 09/30/2003
T-1-P-2	09/19/2003 - 09/30/2005
T-1-P-3	09/16/2004 - 09/30/2005
T-2-M-1	03/15/2003 - 09/30/2004
T-2-M-2	10/01/2003 - 09/30/2005
	Questioned Costs: \$0

This finding is included in Section II of the schedule of findings and questioned costs (750604).

OTHER SCHEDULES

DEPARTMENT OF NATURAL RESOURCES
Summary Schedule of Prior Audit Findings
As of September 30, 2005

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 750401
Finding Title: Revenue for State Parks, Harbor Sites, and Boating Access Sites

Finding: The Department of Natural Resources' (DNR's) internal control did not ensure that all revenue received at State parks, harbor sites, and boating access sites had been properly deposited and recorded in the State accounting records.

Comments: DNR implemented a new electronic Cash, Accounting, and Reporting System (CARS) during fiscal year 2003-04. All sales and revenue information for parks, harbors, and boating access sites where revenue is collected was entered into CARS for fiscal year 2003-04. CARS was reconciled with the Michigan Administrative Information Network* (MAIN) for each location for fiscal year 2003-04. DNR continues to use CARS and reconcile to MAIN by location, ensuring that all revenue received at parks, harbors, and boating access sites has been deposited and correctly recorded in the State's accounting records.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 750402
Finding Title: Retail Sales System Controls

* See glossary at end of report for definition.

Finding: DNR's internal control for retail sales of licenses did not minimize the risk of fraud or misuse of voided licenses.

Comments: DNR administrative procedure 02.05-10 was established but not implemented. This procedure is in need of being updated but the contents and procedural steps are correct. DNR's Customer Systems will work to update this procedure with the latest organizational structure information.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards in the prior Single Audit.

DEPARTMENT OF NATURAL RESOURCES

Corrective Action Plan

As of June 14, 2006

FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

Finding Number: 750601

Finding Title: Retail Sales System Controls

Management Views: The Department of Natural Resources (DNR) agrees with the recommendation and will comply.

Corrective Action: DNR will implement a shortened (three-day) window for agent-initiated sales voids by December 31, 2006. In an effort to reduce license and permit misprints, DNR has purchased improved stock and ribbon material and is researching other stock improvement measures. Also, DNR has dedicated a full-time equated position to research this issue to determine both short-term and long-term solutions.

Anticipated Completion Date: March 2007

Responsible Individual: David Freed, Chief, Office of Land and Facilities

Finding Number: 750602

Finding Title: Service Organization Controls

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: DNR entered into a new contract for the Central Reservation System in March 2006, which included a requirement that the vendor have a SAS 70* internal

* See glossary at end of report for definition.

control review completed within six months of the start of the new contract. DNR will implement an upgrade of the Retail Sales System in August 2006. As part of this process, controls will be documented and tested by the vendor as well as DNR staff. A SAS 70 review of internal control may also be conducted pending the results of the financial upgrade testing and a thorough cost-benefit analysis.

As a point of clarification, the Retail Sales System vendor does not have access to cash handling or receipts; therefore, this finding does not apply in the same manner for the Retail Sales System and the Central Reservation System.

Anticipated Completion Date: Central Reservation System - October 1, 2006
Retail Sales System - December 31, 2006

Responsible Individual: David Freed, Chief, Office of Land and Facilities

Finding Number: 750603

Finding Title: Controls Over Accounts Payable

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: The DNR Grants Management Section will review payments made after September 30, but before the books are closed, to ensure that expenditures were accrued and payables recorded if appropriate. In the event that Grants Management Section staff have questions with respect to the proper fiscal year to charge, they will seek guidance from the DNR Office of Financial Services. Also, the Grants Management Section staff, with assistance from the Office of Financial Services, will review the largest nonresponders to year-end requests for estimated

unbilled grants and make a second contact or estimate a payable, based upon their best judgment. The DNR Office of Internal Audit will review year-end payable calculations and will test large new year payments made shortly after September 30 to determine that charges are being applied to the proper fiscal year.

Anticipated Completion Date: During fiscal year 2005-06 closing

Responsible Individuals: James Wood, Section Chief, Grants Management Section
Joseph Frick, Chief, Office of Financial Services
Thomas Benson, Chief, Office of Internal Audit

Finding Number: 750604

Finding Title: Cash Management

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: The DNR Forest, Mineral and Fire Management Division and Wildlife Division will improve their coordination efforts with the DNR Office of Budget and Support Services to provide for more timely billings and drawdowns of federal funds.

Anticipated Completion Date: Improvements to begin by July 1, 2006

Responsible Individuals: Lynne Boyd, Chief, Forest, Mineral and Fire Management Division
William Moritz, Chief, Wildlife Division
Sharon Schafer, Chief, Office of Budget and Support Services

Finding Number: 750605

Finding Title: Monitoring of Gas Royalty Revenue

Management Views:	DNR agrees in principle and has complied.
Corrective Action:	DNR worked with the Department of Management and Budget on drafting the invitation to bid to ensure that the accounting firm contract would be long enough to provide the reports through the point when production reaches 67.3 billion cubic feet. The contract for the new accounting firm was approved in October 2005 and is for three years with an option to extend, if needed. In addition, the DNR Office of Financial Services has established a liability account for anticipated future payments to the buyer. After revenue is posted each month, Forest, Mineral and Fire Management Division staff provide the Office of Financial Services an estimated revenue amount for the wells associated with the agreement. Payment to the buyer will be based upon the acceptance of the contracted accounting firm reports and in accordance with the agreed-upon schedule with the buyer. DNR believes that it has strengthened its controls to the extent possible and is in compliance with this recommendation.
Anticipated Completion Date:	Completed
Responsible Individual:	Lynne Boyd, Chief, Forest, Mineral and Fire Management Division

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number:	750606
Finding Title:	Cooperative Forestry Assistance, <i>CFDA</i> 10.664
Management Views:	DNR agrees with the recommendation and has complied.

Corrective Action: The DNR Forest, Mineral and Fire Management Division made appropriate adjustments to its performance reporting process beginning with the fiscal year 2005-06 grant cycle to ensure that the total number of applications approved to be funded under the award is accurate. Also, the Division made adjustments to its grant agreement form to ensure that DNR is informing subrecipients of all required federal grant information in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

Anticipated Completion Date: Completed

Responsible Individual: Lynne Boyd, Chief, Forest, Mineral and Fire Management Division

Finding Number: 750607

Finding Title: Outdoor Recreation - Acquisition, Development and Planning, *CFDA* 15.916

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: Regarding reporting, the DNR Grants Management Section has initiated development of a centralized process to track postcompletion inspections. This process will include a written process to identify and track postcompletion inspections, specific responsibilities attached to individual positions related to this process, and specific steps to take in response to issues found during the process.

Regarding subrecipient monitoring, the DNR Grants Management Section will include *Catalog of Federal Domestic Assistance (CFDA)* information in its application materials and project agreements for the Outdoor Recreation - Acquisition, Development and Planning Program.

Regarding special tests and provisions, the Grants Management Section is in the process of implementing a centralized conversion tracking procedure to improve its ability to track and manage conversions.

Anticipated Completion Date: Reporting - September 30, 2008
Subrecipient Monitoring - May 1, 2006
Special Tests and Provisions - May 30, 2006

Responsible Individual: James Wood, Section Chief, Grants Management Section

Finding Number: 750608

Finding Title: Subrecipient Monitoring

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: DNR will identify all subrecipients of federal funds through use of the Michigan Administrative Information Network (MAIN), the Management Information Database (MIDB), and information from divisions. DNR will access and review the OMB Federal Audit Clearinghouse database and the Michigan Department of Treasury Web site to determine if subrecipients have submitted Single Audit reports. For those subrecipients not having Single Audits on the Federal Audit Clearinghouse database or the Michigan Department of Treasury Web site, DNR will communicate directly with the subrecipient to determine if the subrecipient has received over \$500,000 during the subrecipient's fiscal year and is required to file a Single Audit report. All subrecipients identified as requiring a Single Audit report will be requested to send a copy to DNR. DNR will review Single Audit reports and confirm that all OMB Circular A-133 required information and schedules are included. Any exceptions will be followed up.

Anticipated Completion Date: December 31, 2006

Responsible Individual: Thomas Benson, Chief, Office of Internal Audit

Finding Number: 750609

Finding Title: Procurement and Suspension and Debarment

Management Views: DNR agrees with the recommendation and will comply.

Corrective Action: The Purchasing Services Section within the DNR Office of Financial Services will update relevant DNR policies, procedures, and operational guidance to ensure that no purchases of goods and services are made with federal assistance funds from parties on the federal List of Parties Excluded From Federal Procurement or Nonprocurement Programs. Each division's procurement liaison will be responsible to ensure that division staff are aware of changes and provide direction to implement the updated procedures. The procurement liaisons will provide guidance to their respective staff on how and when to use the federal list. DNR's procurement liaison with the Department of Information Technology (DIT) will work to ensure that DIT expenditures of federal funds are subject to the same requirements.

Also, DNR will suggest a Statewide solution to the Department of Management and Budget relative to developing a State accounting system enhancement to help identify and/or disqualify federally debarred vendors for all agencies.

Anticipated Completion Date: June 30, 2006

Responsible Individuals: Alan Marble, Chief, Law Enforcement Division
Lynne Boyd, Chief, Forest, Mineral and Fire
Management Division
William Moritz, Chief, Wildlife Division
Kelley Smith, Chief, Fisheries Division
James Wood, Chief, Grants Management Section
Joseph Frick, Chief, Office of Financial Services

Finding Number: 750610
Finding Title: Cash Management

See Finding 750604 with the findings related to the financial statements and financial schedules.

GLOSSARY

Glossary of Acronyms and Terms

CARS	Cash, Accounting, and Reporting System.
CFDA	<i>Catalog of Federal Domestic Assistance.</i>
CFR	<i>Code of Federal Regulations.</i>
DIT	Department of Information Technology.
DMB	Department of Management and Budget.
DNR	Department of Natural Resources.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
Michigan Administrative Information Network (MAIN)	The State's fully integrated automated administrative management system that supports the accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. MAIN consists of four major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control System (FACS); MAIN Human Resource System (HRS); and MAIN Management Information Database (MIDB).
MNRTF	Michigan Natural Resources Trust Fund.
OMB	U.S. Office of Management and Budget.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not

reflect the actions a prudent person would take in the circumstances.

reportable condition

A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Violations of State laws, regulations, contracts and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

SAS 70

Statement on Auditing Standards No. 70, *Service Organizations*, issued by the American Institute of Certified Public Accountants.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient	A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
unqualified opinion	<p>An auditor's opinion in which the auditor states that:</p> <ul style="list-style-type: none"> a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

